Why Doesn’t Vietnam Grow Faster? State Fragmentation and the Limits of Vent for Surplus Growth

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Vietnam
The Global Economy and Macroeconomic Outlook

Sanjay Kalra

After almost a decade of high growth, Vietnam's growth rate fell during 2011–13. Since 2001, the country has also experienced two bouts of high inflation, booms and busts in equity and real estate markets, and episodes of large capital inflows and outflows. Against the backdrop of the global economy, this paper provides an account of macroeconomic developments in Vietnam during 2011 to 2013, examines the imbalances that came to a head in 2011, the macroeconomic stabilization achieved during 2012 to 2014, and the outlook and challenges going forward. The paper concludes that successfully designing and implementing a broad set of policies — staying the course on macroeconomic stabilization, while accelerating the pace of structural reform significantly, and integrating into the global economy — will allow Vietnam to further advance the remarkable gains that it has already made in poverty alleviation and achieving its Millenium Development Goals.

Keywords: Vietnam, macroeconomics policies, structural reforms, world economy.

1. Introduction

After almost a decade of high growth, Vietnam tumbled to low growth rates. Prior to the Global Financial Crisis (GFC) in 2008, real GDP growth averaged 7.25 per cent during 2001–07, one of the highest in Asia. Average annual growth slowed down to 5.5 per cent in 2008–09; revived to a little over 6.25 per cent in 2010–11 with expansionary policies; and then fell again to 5.25 per cent during 2011–13 (Figure 1). At the same time, Vietnam has experienced two bouts of high inflation (in 2008 and 2011), booms and busts in equity and real estate markets, and episodes of large capital inflows and outflows (Figure 2). The high growth rates were associated with rapid industrialization in Vietnam, fuelled by easy credit, capital inflows and, correspondingly, high investment rates, while total factor productivity

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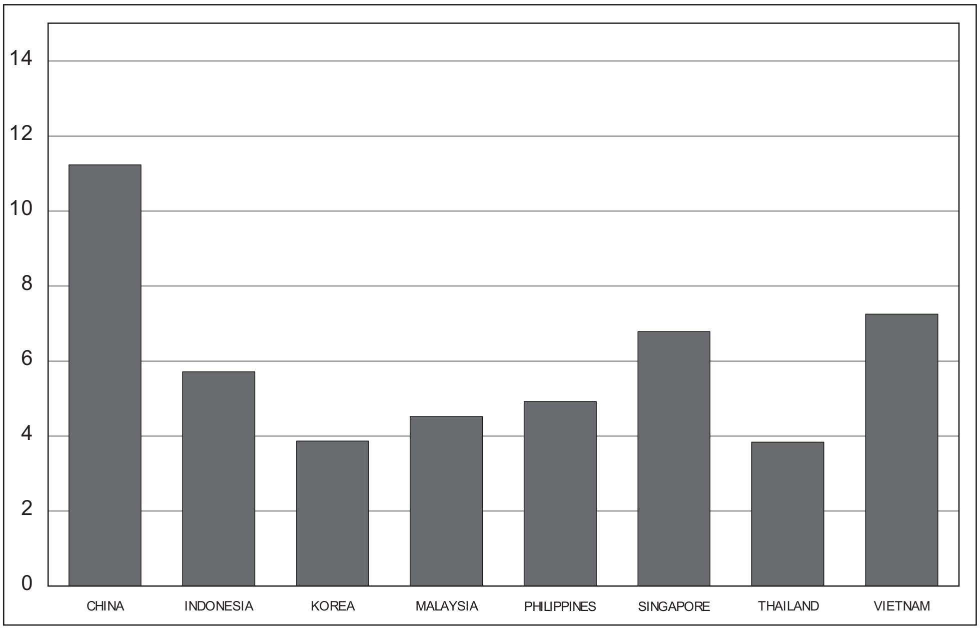
FIGURE 1
Real GDP Growth
(Annual average, 2005–10, in per cent)



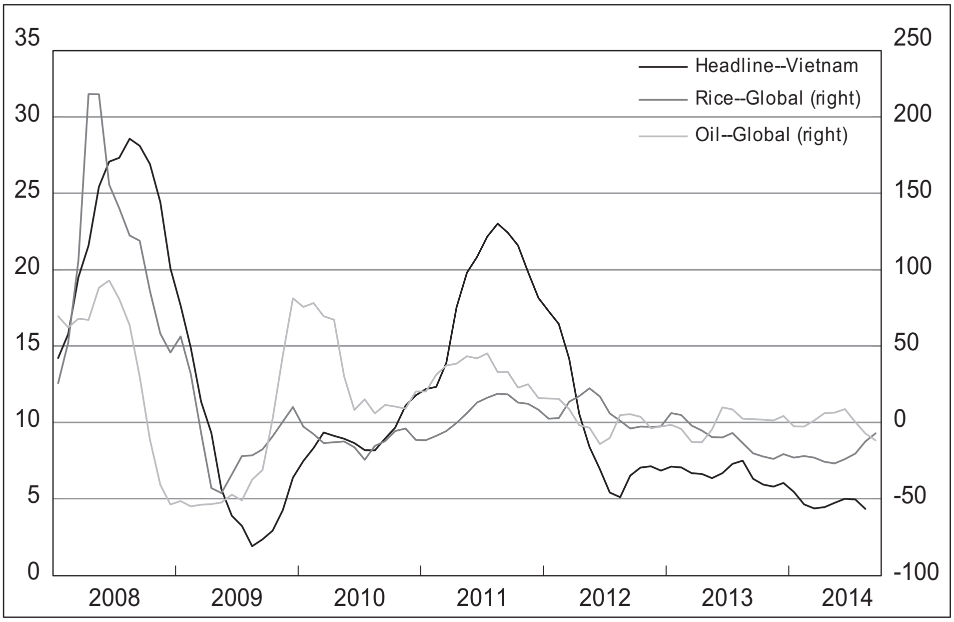
SOURCES: World Economic Outlook, IMF; and author's calculations.

(TFP) growth was low. Much of the growth was accounted for by a rapidly growing labour force and capital accumulation. At the same time, macroeconomic imbalances were building up which first surfaced with the GFC.

The macroeconomic imbalances came to a head again in early 2011. The official exchange rate had to be devalued after international reserves fell to low levels. At the same time, headline inflation rose during 2011 and peaked at over 20 per cent (12-month) in August. In the three years since then, inflation has been brought down to stable single digits and international reserves have risen with current account surpluses. However, growth has slowed, domestic demand remains weak and the economy is running on a single engine of external demand and exports (Table 1). At the same time, an extensive agenda of structural reforms remains to be implemented to restore growth to sustained, high levels consistent with Vietnam's medium-term potential.

This paper focuses on macroeconomic developments in Vietnam during 2011–14. Several events, domestically and abroad, formed the backdrop for these developments. These include Vietnam's accession to the World Trade Organization (WTO) in early 2007 and the onset of the GFC in late 2008. The remainder of this paper is organized as follows. Section 2 examines the external conditions which form the backdrop for international prices and global demand for the Vietnamese economy, as well as for capital account flows. Section 3 examines the gains in macroeconomic stabilization achieved by Vietnam during 2012 to 2014, before turning to the outlook for 2015. This section also discusses the policy priorities for restoring growth over the medium term against a backdrop of Vietnam's domestic

FIGURE 2
Inflation
(12-month, in per cent)



SOURCES: GSO; World Economic Outlook, IMF; and author's calculations.

TABLE 1
Vietnam: Components of Aggregate Demand
(Annual average percent change)

	Consumption			*Gross Capital Formation*		
	Total	*Private*	*Government*	*Total*	*Fixed*	*Change in stocks*
2005–10	7.0	6.9	8.8	11.8	11.2	21.9
2011–13	4.9	4.7	7.2	0.3	—	—

SOURCE: GSO; and author's calculations.

advantages, including its favourable demographics. Section 4 offers concluding remarks.

2. The Global Economy

The *World Economic Outlook* (IMF, October 2014) projected global growth to increase from 3 per cent in 2013 to 3.3 per cent in 2014 and 3.8 per cent in 2015. The United States was projected to grow at 2.25 and 3.75 per cent in 2014 and 2015, respectively (2 per cent in 2013); the euro area was expected to expand by 0.75 and 1.5 per cent (after negative growth in 2012 and 2013), but there was continued divergence between a more robust core (Germany) and still fragile periphery (Italy, Greece, Spain and Portugal). Robust growth was expected in Asia and sub-Saharan Africa. Growth prospects were more subdued in Latin America. In the Middle East and North Africa, several factors continued to weigh on growth prospects.

Acute risks to the growth forecast had not disappeared and downside risks continued to dominate. These included the impact on global economy from geopolitical tensions in Ukraine and Russia, and the Middle East. An escalation of tensions was expected to result in repricing of risky assets and wider spillovers. In addition, there were risks to activity from low inflation or deflation, a risk that was most pronounced in the euro area. Inflation was running well below the 2 per cent target of the European Central Bank (ECB), and the inflation could stay below target in the coming years because of high unemployment and economic slack. This lowflation/deflation remains a problem because with interest rates close to the zero bound, it would imply higher real interest rates, raising borrowing costs and slowing down the economy. It would also raise already high real debt burdens (both public and private), generating an additional drag on growth. As regards emerging markets, these economies had to operate in an external environment which is more sensitive to perceived vulnerabilities. There were continued concerns of heightened volatility as financial markets tried to factor in the timing and speed of "tapering". Commodity prices remained relatively high, but were not expected to rise further. There were downside risks to the prices of some commodities coming from a supply response to high prices. There was also the tail risk that a sharper-than-expected slowdown in China's growth would affect commodity prices and commodity exporters adversely.

3. Vietnam

3.1 Macroeconomic Imbalances in 2011

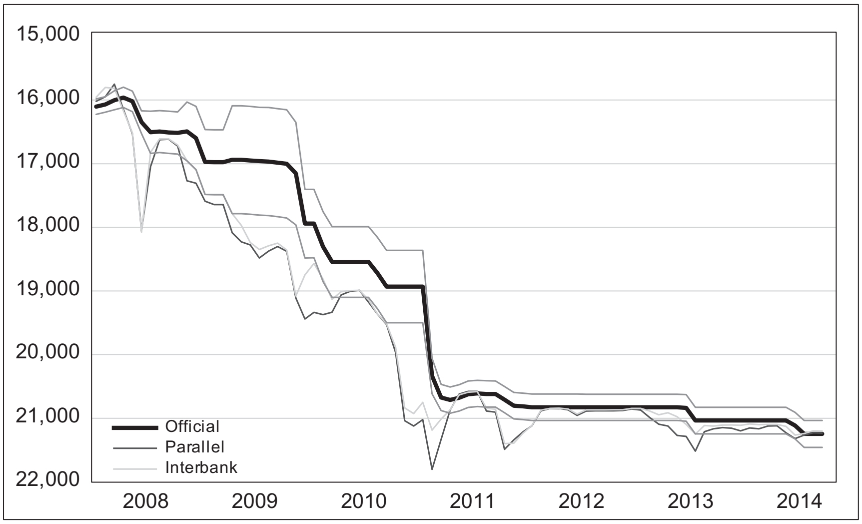
For almost a half-decade prior to 2011, Vietnam experienced a set of domestic and external factors which generated high growth but also sowed the seeds of macroeconomic imbalances. As these external and domestic factors came to a head, macroeconomic imbalances became evident in early 2011. The official exchange rate was devalued by nearly 10 per cent in mid-February in the wake of low international reserves and a stabilization programme was adopted under Resolution 11 (Figures 3 and 4). How did the economy come to such a pass? For analytical purposes, it is useful to break down developments into three periods: prior to 2008(Q3), 2008(Q4) to 2011(Q1), and thereafter.

Developments prior to 2008(Q3). On the external front, high growth rates in the global economy since the early 2000s helped support export and growth in Vietnam. Sharply rising commodity prices in 2007 to mid-2008 especially rice and oil, transmitted inflationary pressures to Vietnam, particularly during the first inflationary episode in 2008. The impact of commodity price increases was possibly smaller during the 2011 inflation, both because the increases were smaller and also because the contribution of easier macroeconomic policies was larger. For a net exporter, the inflationary impact of a large increase in global rice prices could well have been higher than other economies, through a direct effect on domestic prices and indirectly through second round income effects.

In the run-up to WTO accession in January 2007, substantial capital inflows into Vietnam's stock market contributed to a swelling of banking sector Net Foreign Assets (NFA), an increase in the State Bank of Vietnam's (SBV) international reserves and a stock market boom (Figure 5). The HCMC stock market index rose from under 250 in early 2005 to a peak of 1,200 in late-February 2007. With insufficient sterilization of the inflows, growth of monetary aggregates and credit, in particular, was very high, averaging over 30 per cent per year over 2005–08. Credit growth peaked at around 55 per cent (year-on-year) in 2007 (Figure 6).

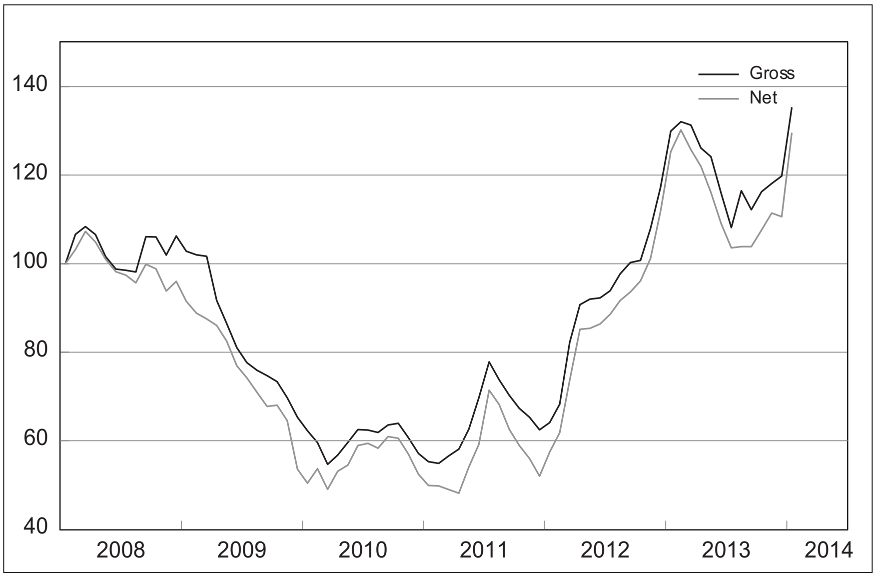
The Global Financial Crisis to 2011(Q1). With the onset of the GFC in 2008Q3, capital flows turned sharply negative and the processes of NFA increases, reserve accumulation and the stock market rises went into reverse gear. The stock

FIGURE 3
Exchange Rates
(VND/US$)



SOURCES: State Bank of Vietnam; and author's calculations.

FIGURE 4
International Reserves
(Index: January 2008=100)

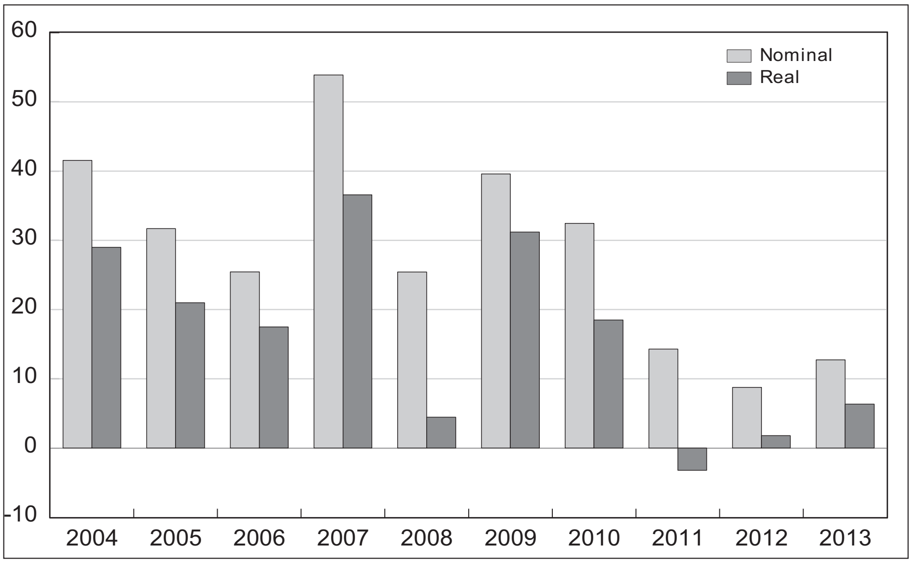


SOURCES: State Bank of Vietnam; and author's calculations.

FIGURE 5
HCMC Stock Market
(Index)

SOURCES: HCMC Stock Exchange; and author's calculations.

FIGURE 6
Banking Sector Credit Growth
(In per cent, y/y)



SOURCES: State Bank of Vietnam; and author's calculations.

market lost all of its gains made during 2005 to mid-2008 in a space of few months. At the same time, policy interest rates were raised by almost 10 percentage points in response to the rising inflation. Correspondingly, the growth of monetary aggregates and credit slowed sharply in 2008.

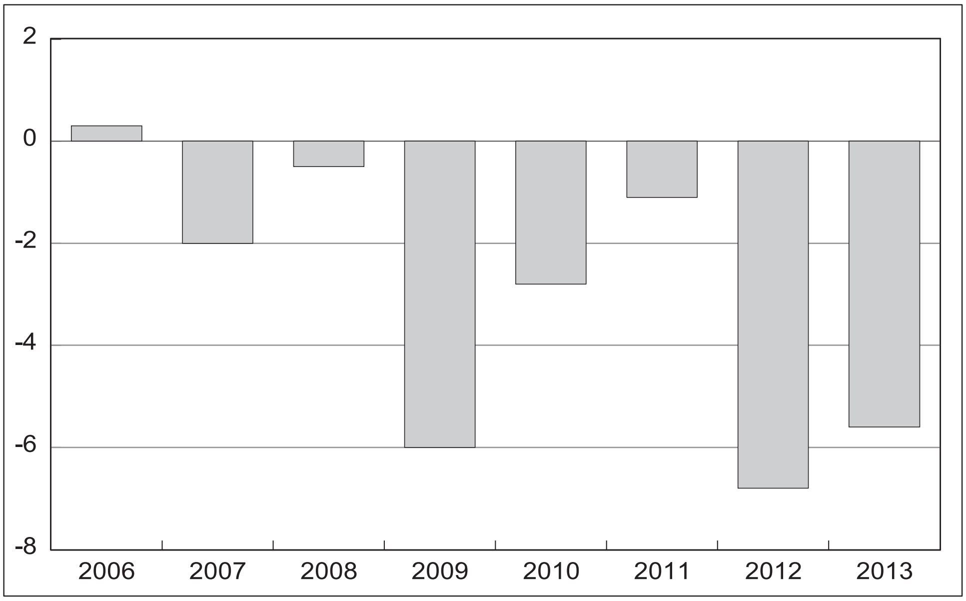
Macroeconomic policies to stabilize the economy and revive growth took the form of higher public investment, a larger fiscal deficit in 2009, and a reduction in policy rates as inflation came down quickly after 2008(Q3). Fiscal policy was eased considerably in 2009, in substantial measure financed by external concessional aid (Figure 7). The budget deficit rose to over 6.5 per cent in 2009 (compared to an annual average of under 0.75 per cent during 2006–08).

The policy rates also came down quickly and, by mid-2009, were at their levels in early 2008 (Figure 8). The growth of monetary aggregates resumed in 2009. Broad money growth (12-month basis) averaged over 30 per cent during 2009 and 2010, this time with a substantial contribution from credit growth. All in all, it was a period of easy monetary conditions.

The loose domestic policies contributed to an increase in current account deficits (Figure 9). In the absence of offsetting portfolio inflows, as had been the case in during 2005–07, the result was steady depreciation pressure on the exchange rate. The parallel and interbank market exchange rates traded outside of the SBV's official band for all of 2008–10. Intervention failed to stem exchange rates pressures. The level of international reserves fell.

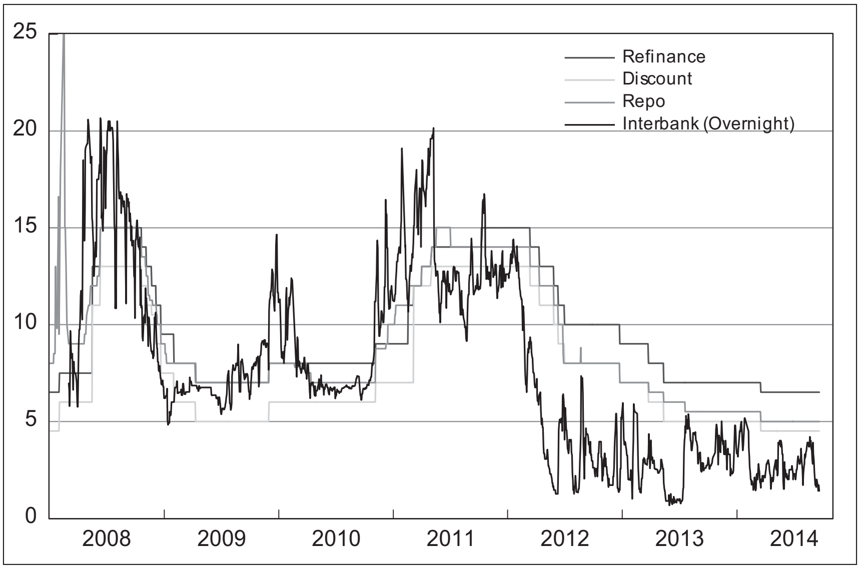
Capital flows had been large and positive in the run-up to WTO accession and thereafter, contributing to a stock market bubble. With the onset of the GFC in 2008(Q3), these flows turned negative and the stock market crashed, losing all of the gains made during 2005 and

FIGURE 7
Fiscal Balance
(In per cent of GDP)



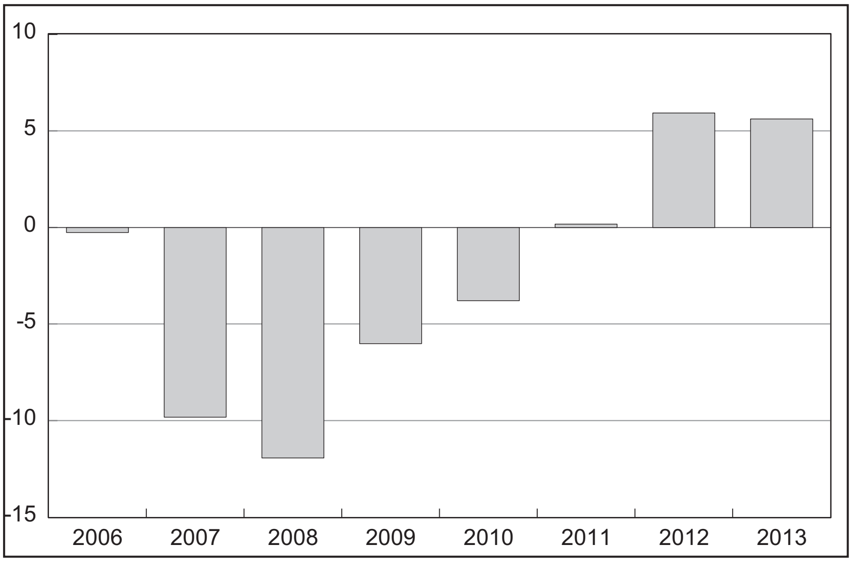
SOURCES: Ministry of Finance; GSO; and author's calculations.

FIGURE 8
Interest Rates
(In per cent)



SOURCES: State Bank of Vietnam; and author's calculations.

FIGURE 9
Current Account Balance
(In per cent of GDP)



SOURCES: State Bank of Vietnam; GSO; and author's calculations.

2007. A combination of the stock market crash, continued high credit growth and banking sector developments generated an unsustainable rise in real estate market. At the same time, the resurgence of higher inflation, run-up in global gold prices, and unstable monetary conditions generated asset substitution to gold in investor portfolios.

All of these developments were taking place against the backdrop of significant changes in the banking and state-owned enterprise (SOE) sectors:

- State presence in the banking sector is substantial. Five large state-owned banks account for half of the banking system assets and deposits. These banks operate in specific sectors of the economy and play social policy roles. The state is also an indirect owner of financial institutions through several different channels: both the state and SOEs are shareholders of some joint stock banks (JSBs), and banks are often investors in other banks. The ownership structure of banks is complex and opaque, with potentially negative consequences for financial stability. The system is characterized by a high degree of cross ownership among banks, and by direct ownership of banks by economic groups whose structure is not well understood. As a result, it is not possible to ascertain whether these structures have led to an overstatement of the capital of financial institutions through multiple gearing, and to the avoidance of prudential regulations, such as limits on credit concentration. The complex web of interrelations between the state, state-owned, and private entities is an important source of vulnerability. State-owned entities (banks and non-banks) exhibit inadequate internal governance. Directed and connected lending to favoured sectors and conglomerates is widespread in state-owned commercial banks (SOCBs). Among JSBs, there are concerns about their use as captive sources of financing for connected economic groups.
- Despite better implementation in recent years, the regulatory and supervisory framework needs to be strengthened significantly, especially with regard to enforcement. Systematic macrofinancial analysis needs to be conducted, and weaknesses in microprudential supervision of banks and other financial institutions need to be addressed. Supervision is largely compliance-based and features little or no assessment of risks and vulnerabilities. In spite of the large number of conglomerates, consolidated supervision is not practised. The SBV exercises ownership rights in SOCBs and this poses a potential conflict of interest for the supervisors.
- Rapid expansion of the banking system also made a contribution to macroeconomic imbalances. The number of banking licences rose during 2005 to 2008 as a number of provincial joint stock banks were allowed to operate on a national scale. Intense competition for deposits among these banks contributed to an increase in deposits and lending rates. Within the constraint of overall deposit growth, the smaller banks, unable to secure enough shift in deposits from the bigger, established banks turned to the interbank market for meeting their expansion goals. These short-term borrowings in the interbank market were used to make longer term loans, quite often to connected parties, especially for investment in the real estate sector. As a result, sectoral and concentration risks were added to maturity mismatches in banks' balance sheets. As perceptions of credit risk among banks increased, the smaller banks began to be increasingly priced out and interbank rates rose.
- Vietnam's public sector continues to play a leading role in the economy. This role, and the SOE's dominance of key industries, is reflected in their share of business assets, output, and employment in the economy. SOEs are also important from the fiscal point of view, contributing more than one-half of corporate income tax revenue and one-third of domestic value added taxes. It is generally believed that government connections and preferential access to credit and other inputs (such as land) gives SOEs an advantage over private enterprises. The true financial state of SOEs remains publicly unknown, but they are estimated to account for a significant portion of total bank non-performing loans (NPLs). Along with this

dominance, governance weaknesses and a lack of adequate competition, SOEs may well have become increasingly inefficient over time. Signs of these inefficiencies were very visible on the international scene in the default by the largest Vietnamese shipbuilder (Vinashin) in 2010.

3.2 Macroeconomic Stabilization: 2011(Q1) to 2014(Q3)

The key objective of the programme put in place as part of Resolution 11 in February 2011 was to restore macroeconomic stability, through tighter macroeconomic policies. The effects of the stabilization programme took some time to take hold, as the parallel market exchange rate remained volatile for the most part of 2011 after the February depreciation of the official exchange rate. There was also considerable liquidity stress in the banking system especially towards the latter part of the year, and interbank rates climbed to high levels, and stayed at these levels even after inflation had begun to decline. Only after SBV efforts to calm liquidity conditions did the interbank rate begin to fall in early 2012.

The stabilization programme did eventually take hold. The exchange rate stabilized and headline inflation declined from over 20 per cent (year-on-year) in August 2011 to single digits in 2012. It has remained in the single digits since then. The SBV had already begun to raise policy rates in early 2011 and continued to do so for the remainder of the year. In addition, credit growth limits placed by the SBV on banks and increasingly distressed domestic enterprises led to a sharp slowdown in credit growth. Real banking sector credit growth turned negative in 2011. The budget deficit fell and the current account turned to a small surplus.

Administrative controls in the monetary and financial sector played an important role in the stabilization effort. The SBV reintroduced caps on dong deposit interest rate caps to control competition among banks, along with caps on short-term lending rates for loans to priority sectors (e.g. agriculture and rural development, exports, and small and medium enterprises). An important component of these controls was bank-by-bank credit growth targets as banks were classified into buckets according to their financial and balance sheet conditions. The SBV also managed closely the dong-dollar deposit interest rate differentials. Prudential caps were also placed on bank lending to selected sectors, such as real estate and securities. Foreign exchange surrender requirements were imposed on SOEs and the scope of foreign currency borrowing was narrowed to mostly exporters who had demonstrated foreign exchange earnings. The SBV also disallowed bank lending and deposits in gold and disallowed conversion of gold deposits into dong for lending.

However, real GDP growth slowed in 2012 and 2013 and appeared to be stabilizing in the 5 to 5.5 per cent range. While a slowdown in the global economy contributed to this outcome, domestic imbalances and inefficiencies were equally, if not more, important. Export growth remained strong supported by export-oriented sectors and foreign-invested enterprises. However, domestically oriented sectors continue to struggle and are yet to find a solid footing. Private consumption growth has slowed considerably in 2011–12 compared to 2006–10, and investment growth was negative.

With continued strong export performance, a slowdown in imports and robust remittances, the current account moved first to rough balance in 2011 and then to surplus during 2012 and 2013. The exchange rate was also broadly stable and the current account surpluses contributed to a rapid buildup of international reserves. As inflation came down, it was possible for the SBV to bring down the structure of interest rates — policy, deposit and lending rates. With these achievements, the macroeconomic management credentials of the SBV and its credibility in the market have improved. At the same time, the Ministry of Finance (MOF) has exercised some restraint in providing fiscal stimulus. Credit growth picked up in 2012 and 2013, but only modestly in real terms, despite a significant decline in lending rates, as financial fragility continued to hamper credit intermediation.

The slow growth has had knock-on effects on budget deficits which rose in 2012 and 2013, especially in 2013 as revenue collection fell below budget targets. The budget deficit had averaged 2 per cent of GDP during 2010–11, but rose to 6.75 per cent of GDP in 2012. For 2013, with revenue shortfalls — especially in the VAT and corporate income tax — the deficit is estimated to have been about 5.5 per cent of GDP (IMF definition). The fiscal stimulus package, including tax deferrals and some reductions in tax rates, provided temporary support to distressed enterprise, but could not obviously address the fundamental problems of weak demand, slowing growth and structural inefficiencies.

Some progress was also made in stabilizing the banking sector. Starting in late 2011, the SBV allowed the merger of small, weak banks into larger banks to further a consolidation of the financial sector, as envisaged in the Banking Sector Restructuring Plan, 2011–15. As of 2014(Q1), several banks had been merged, and other mergers are contemplated going forward. These consolidations reduced liquidity stress in the banking system, along with sufficient liquidity provision by the SBV. Interbank rates fell significantly in 2012 and 2013, compared to levels in 2011. The slower credit growth in the banking sector also reduced the credit to GDP ratio significantly. A centralized asset management company, the Vietnam Asset Management Company (VAMC), was established in mid-2013 and commenced operations in October 2013. The establishment of the VAMC is an important first step of banking sector reforms to address the problem of NPLs in the banking system. Some efforts have also been made to tighten prudential regulations.

3.3 Outlook

Several factors continue to shape the economic outlook for Vietnam in 2015. Weak demand conditions will likely continue to dampen inflationary pressures, and inflation in 2015 should continue to remain in the single digits. Major structural weaknesses — in the banking and SOE sectors — are diminishing Vietnam's growth potential. These reforms are now macrocritical. Without these reforms, growth will continue to be held back by low productivity, resource misallocation, impaired bank and corporate balance sheets and inefficiency. The International Monetary Fund's (IMF) 2014 Article IV Consultation Staff Report projected real GDP growth for Vietnam at 5.5 and 5.6 per cent in 2014 and 2015, respectively.

Risks to this outlook come both from domestic and external factors. The outlook for global growth remains tentative. This could spill over to Vietnam, while heightened uncertainty or renewed volatility related to global financial conditions could result in capital outflows and weaken reserves. Vietnam has limited policy space to offset these external shocks and efforts should be directed towards rebuilding domestic and external buffers.

3.4 Structural Reforms

Even as growth has slowed down, major structural weaknesses are holding back Vietnam's medium-term growth potential. Even though interest rates have declined, liquidity in the banking system is plentiful, and monetary conditions are accommodative, banking sector credit growth remains sluggish. Bank balance sheets remain compromised by high NPLs and the room for further support from monetary policy for aggregate demand may well be limited. At the same time, higher budget deficits during 2012 to 2014 have led to a noticeable increase in the level of public debt. Under conditions where the space for macroeconomic policies to support demand has diminished, structural reforms are now critical to revive growth. These reforms relate to three areas identified by the Government of Vietnam — the banking sector and SOE sectors, and public investment. Without structural reforms in these areas, growth will continue to be held back by low productivity, resource misallocation, impaired bank and corporate balance sheets and inefficiency in several SOEs.

Banking sector reform must remain a top priority. Addressing weaknesses related to asset quality, NPLs, provisioning and capitalization is critical to creating an environment in which banks intermediate national savings to productive investment. Problems need to be addressed at all banks, large and small, state-owned or joint stock. To restore banking system efficiency, measures need to be taken to recapitalize banks, strengthen banking supervision and regulation and implement the workout scheme for NPLs. In particular, supervision over the banks needs to be tightened significantly and to ensure that the banks meet the SBV's prudential norms, including capital adequacy. Strengthening credit risk analysis and governance by promoting greater transparency should also be a priority. However, the VAMC should not be allowed to become a vehicle for extended liquidity support for insolvent banks as this would weaken incentives for restructuring and delay necessary banking sector recapitalization. The VAMC would require more authority and resources — financial and human — to resolve NPLs in the banking system. This, in turn, would require amendments to the legal framework across a range of areas to facilitate loan and collateral resolution. More broadly, capital markets can be further developed to supplement the banking system, provide alternative risk-return opportunities to investors, attract stable foreign portfolio inflows, and reduce holdings of gold as a store of wealth.

The financial condition of banks cannot be improved without taking a close look at their borrowers. A considerable part of the banking sector loans are to SOEs. Therefore, reform of SOEs is important. The true financial condition of SOEs must be disclosed to the public, including their audited income statements and balance sheets, and their borrowings from the banking system. These enterprises use public money for their operations and the public needs to be informed of their operations. Once the true financial condition of these enterprises has been revealed, steps can be taken to improve their operations and governance structures. These plans must be formulated and implemented in a time bound manner. The government has embarked on an equitization programme of SOEs which takes the first steps towards greater involvement of the private sector in the economy. Under this programme, the equitization of some large SOEs has already been undertaken in 2014, and others are planned over 2015. However, several of these equitizations still envisage a majority role for the state in these SOEs. As a result, further steps towards larger equitization, greater disclosure and improved governance will be required to improve efficiency in these enterprises.

Restructuring public investment is essential to ensure that the taxpayers receive a good "return" on their contribution to the budget. Better schools and health facilities create conditions for improvements in human capital. Better infrastructure reduces the cost of doing business, among other things.

3.5 The Long Haul

As Vietnam seeks to return to higher, sustained growth rates over the longer horizon, it is faced with opportunities and challenges. Growth has been slowed in recent years by economic inefficiencies in the public and private sectors, and calls for structural reforms. The sources of growth need to be rotated to improvements in factor productivity and the business climate. At the same time, Vietnam is endowed with several sources of comparative advantage. It is located in one of the most dynamic regions of the world, with a wealth of opportunities to integrate into regional supply chains as well as to forge new horizons through its current and prospective participation in several regional trading arrangements. Prominent among these are the establishment of the ASEAN Economic Community (AEC) in 2015, ongoing Trans-Pacific Partnership (TPP) discussions and negotiations on several free trade agreements. Vietnam is also in a very favourable phase of its demographic transition relative to the more mature economies of the region — Japan and Korea — and increasingly China, which either have more mature population pyramids or are rapidly approaching less favourable dependency ratios.

Sources of growth. The composition of growth during 2000–10 shifted markedly from the period 1990–2000 (Vu 2010). GDP growth averaged 7.25 per cent during 1991–2000 (Table 2). A substantial share of this growth (34 per cent) came from

TABLE 2
Vietnam: Sources of Growth

	Vietnam			*China*			*Indonesia*		
	1990–2010	*1990–2000*	*2000–2010*	*1990–2010*	*1990–2000*	*2000–2010*	*1990–2010*	*1990–2000*	*2000–2010*
GDP Growth	7.16	7.30	7.01	8.97	7.10	10.85	4.61	4.13	5.08
Capital Input	4.47	3.54	5.40	5.76	5.22	6.30	3.19	3.52	2.87
ICT	0.66	0.37	0.94	0.99	0.81	1.16	0.41	0.21	0.61
Non-ICT	3.81	3.16	4.46	4.77	4.41	5.14	2.79	3.31	2.26
Labor Input	1.37	1.31	1.44	0.55	0.69	0.40	1.05	1.01	1.10
Quality	0.09	0.08	0.11	0.15	0.15	0.15	0.17	0.17	0.17
Hours	1.28	1.23	1.33	0.40	0.54	0.25	0.89	0.85	0.93
TFP	1.31	2.46	0.16	2.67	1.18	4.16	0.36	–0.4	1.12

SOURCE: Vu (2010).

TFP growth. The remainder came from capital accumulation (48 per cent) and labour input (18 per cent). Growth slowed down to an annual average of 7 per cent during 2001–10. Of this, the share of TFP fell dramatically to under 5 per cent, while the share of capital rose to over 75 per cent. Some of this growth is attributable to investment in real estate and construction, while another part may have been due to substantial capital formation in the inefficient SOE sector.

The large shift in the composition of growth to capital accumulation and the decline in the contribution of efficiency gains points both to the growing inefficiency in the economy and a need for structural reforms if the higher growth rates are to be regained and the large increases in labour force are to be absorbed productivity with rising wages and incomes.

Demographics. Vietnam is among the few countries in East Asia, which is now believed to be in a period of “demographic dividend”. Population growth is positive, fertility rates have declined, the labour force is growing, dependency ratios are falling, health and education indicators are favourable, wage rates are competitive in the region, and income levels have risen steadily. This means that there are two or more persons of working age (15–60) for every person of dependent age (under 15 or 60 and over). The population pyramid of Vietnam shows the low dependency ratio. This phase in Vietnam’s demographic transition is projected to last about thirty years, from 2010 to 2040 (UNFPA 2010). It is also expected that Vietnam will add, during 2011–20, on average, about 1 million people of working age per year to its labour force.

This phase of the demographic transition presents opportunities and challenges. On the one hand, an abundant supply of labour resources provides the fodder for economic growth and expanding market demand. At the same time, the additions to the labour force need to be absorbed in gainful employment with prospects of higher wages and productivity. It also creates challenges in terms of expanding health, education, infrastructure and social security to keep pace with the growing population.

International and regional integration. Further integration into global and regional economies provides a significant growth opportunity for Vietnam from an already strong initial starting point. Over the last decade, the share of trade to GDP has increased significantly. At the same time as the increase in volume, the composition of trade has also shifted, first from agricultural products to garments and footwear; then to more processed industrial products, and more recently to electronics and mobile phones. Going forward, mobile phones are the fastest growing of Vietnam's exports. These shifts are a testimony to the shift in the structure of Vietnam's economy, and bode well for the future as they reflect the economy's resilience. These notable shifts in the structure of Vietnam's exports have been supported by large FDI inflows.

Vietnam's efforts to further integrate into the global economy continue with the impending establishment of the AEC in 2015, and the gains for Vietnam are potentially significant. Spanning a land area of 4.44 million km^2, over 600 million people and a combined GDP of more than US$2.3 trillion (2012), ASEAN comprises ten economically diverse nations in Southeast Asia, ranging from Singapore, with the third highest GDP per capita in the world, to Myanmar, ranked 162nd among 187 countries. The region has witnessed impressive growth over the last ten years, except during the recent financial crisis, in which the less developed countries, including Cambodia, Laos, Myanmar and Vietnam (collectively CLMV) experienced relatively rapid rates. The region's trade to GDP ratio is 107 per cent, while Singapore and Vietnam are even higher (285 per cent and 160 per cent, respectively). Petri, Plummer and Fan (2012) estimate welfare gains from implementing the AEC under several scenarios that introduce the elements of the AEC Blueprint and new international agreements with external partners. Full implementation of AEC would raise ASEAN real incomes by US$69.5 billion or 5.25 per cent over a 2004 baseline. All ASEAN economies would gain from the AEC, ranging from 2.8 per cent (Vietnam) to 9.7 per cent (Singapore). The benefits are larger for those economies that are relatively heavily protected initially by tariffs and non-tariff barriers (NTBs), such as Cambodia and Indonesia. If ASEAN implements FTAs with major partners, ASEAN economies with the strongest linkages outside the region would enjoy larger benefits from deepening external integration. In the best-case scenario where ASEAN could conclude agreements with the United States and the European Union (EU), welfare gains would double to US$151 billion or 11.5 per cent of ASEAN GDP. Vietnam tends to have the largest gains (about 30 per cent of GDP) from agreements that improve access to its main markets.

Vietnam has also made a strong commitment to the TPP negotiations. Analytical studies of the TPP suggest that it is likely to favour economies that are relatively small and initially protected, and do not yet have a free trade agreement with the United States. The five largest gainers, in percentage terms, would be ASEAN economies, ranging from 4 per cent for Indonesia to 14 per cent for Vietnam. In making these estimates, of course, several assumptions are made as the negotiations are still under way. For instance, in the area of textiles and apparel — which is of particular interest to Vietnam — it is assumed that 60 per cent of textiles imported from other TPP members will qualify for preferential tariffs in the United States. However, only about a quarter of Vietnam's garment exports are expected to meet the strict yarn-forward rule of origin, which is the general rule the United States is advocating in the talks.

4. Concluding Remarks

What are the policy priorities as Vietnam looks to 2015 and beyond? Macroeconomic stability must be maintained. Continued macroeconomic stability will require that sound macroeconomic policies be followed going forward. Monetary and exchange rate policies should aim to keep inflation in the single digits. International reserves have increased, but these buffers need to be further built up to ensure that Vietnam can withstand internal and external shocks with more ease. The fiscal position needs to be restored to a consolidation path to support macroeconomic stability and ensure public debt sustainability over the medium term.

Successfully designing and implementing a broad set of policies — staying the course on macroeconomic stabilization while accelerating significantly the pace of structural reform and integrating into the global economy — will allow

Vietnam to further advance the remarkable gains that it has already made in poverty alleviation and achieving its Millennium Development Goals over the past decade. Vietnam is a country endowed with many advantages, including a young and hardworking population. Utilizing these endowments well should be a key priority for Vietnam's policy-makers.

NOTE

This paper is based on the presentation made by the author at the Vietnam Forum 2013 hosted by the Institute of Southeast Asian Studies in Singapore on 30 October 2013. It has been updated to reflect developments since that time. The views expressed in this paper are those of the author and do not necessarily represent those of the IMF or IMF policy.

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